

INDEX

	PAGE
Statement	1
Argument	1

TABLE OF CASES CITED

<i>Adams v. United States</i> , 116 F. (2d) 199.....	3
<i>Childs v. Radzevich</i> , 139 F. (2d) 374.....	3
<i>General American Life Ins. Co. v. Central Nat. Bank</i> , 136 F. (2d) 821.....	3
<i>Gerard v. Empire Square Realty Co.</i> , 195 App. Div. 244	13-14
<i>Hawkins v. Sims</i> , 137 F. (2d) 66.....	3
<i>Montgomery Ward & Co. v. Duncan</i> , 311 U. S. 241.....	2, 3
<i>Nelson v. Hatch</i> , 70 App. Div. 206, aff'd. 174 N. Y. 546	6
<i>Pennsylvania R. Co. v. Chamberlain</i> , 288 U. S. 333....	3
<i>Petze v. Leary</i> , 117 App. Div. 829.....	5, 8
<i>Pruitt v. Hardware Dealers Mut. Fire Ins. Co.</i> , 112 F. (2d) 140	3
<i>Tams-Witmark Music Library v. New Opera Co.</i> , 298 N. Y. 163.....	7
<i>Topken, Loring & Schwartz, Inc. v. Schwartz</i> , 249 N. Y. 206	5
<i>United States v. Socony-Vacuum Oil Co.</i> , 310 U. S. 150	3

OTHER AUTHORITIES CITED

Securities Act of 1933:

Section 11(a)	10
Section 17(a)	10



Supreme Court of the United States

OCTOBER TERM 1948

No. 765

THE GRAYSON SHOPS INCORPORATED (OF CALIFORNIA), NAME CHANGED TO GRAYSON-ROBINSON STORES, INC.,

Petitioner,

v.

HERBERT D. STONE.

PETITIONER'S REPLY BRIEF

Statement

Respondent, in his effort to confuse the issues, chooses to discuss matters not raised in the petition. In addition, respondent refers to some alleged arguments and cases in petitioner's brief which do not appear at all therein. This reply will be limited to those matters as to which respondent has attempted to make answer to the issues raised in the Petition.

Argument

1. We have urged that the direction of a verdict against the petitioner was error, and, in our main brief, have shown that there were numerous issues of fact which should have been left to the jury, and which the Court of Appeals itself assumed to determine. Respondent (Br. pp. 8-12) seeks to sustain the direction of a verdict on the theory

that the court below was required to weigh the evidence and to direct a verdict in respondent's favor if, on a motion for a new trial, a jury verdict for petitioner would have been set aside as against the weight of the evidence. We have pointed out at page 9 of the Petition that the Court of Appeals for the Second Circuit has, in several cases in addition to the instant one, directed verdicts or sustained directed verdicts, on issues other than negligence, predicated upon its judgment as to the weight of the evidence and credibility of the witnesses. This the respondent, far from denying, undertakes to justify as the proper standard.

In line with his view of the appropriate standard, respondent discusses and urges this Court to pass upon the credibility of the witnesses. Thus, at pp. 34 and 49-50 of his brief, respondent attacks Diamond's credibility in testifying that the negative covenant was inserted in the letter agreement solely at respondent's request and to accommodate him; at pp. 13-14 and 30-31 he attacks the credibility of Handmacher, chairman of the Klein board, who denied respondent's testimony that he (Handmacher) had been notified of respondent's use of corporate funds for personal purposes, and denied that respondent had informed the directors and stockholders of Klein that respondent's charges on the Klein books were personal ones prior to procuring their write-off (see Br. p. 22 where respondent fails to mention this denial); and at pp. 27-28, where he attacks Lauterbach's credibility.

In support of his position that the court must weigh the evidence on a motion for a directed verdict, respondent cites cases in this Court, and in the Third and Eighth Circuits (Br. pp. 8-12), which are indicated to be contrary to the cases cited in petitioner's brief at pp. 13-14 with respect to the proper standard to be applied upon a motion for a directed verdict, and at p. 20 with respect to testing the credibility of witnesses. The attention of the Court is respectfully called to its more recent decisions in *Montgomery Ward & Co. v. Duncan*, 311 U. S. 243, 249, 251 and *United*

States v. Socony-Vacuum Oil Co., 310 U. S. 150, 254 where it held that a Federal court may not upon a motion for a directed verdict weigh the evidence as it would upon a motion for a new trial. The holding in these cases are in direct conflict with the language of *Pennsylvania Railroad Co. v. Chamberlain*, 288 U. S. 333, 343 cited by respondent. We note that the following decisions in the circuits indicated are in accord with the *Montgomery Ward* case, *supra*: *Hawkins v. Sims*, 4th Cir. 137 F. (2d) 66, 67; *Pruitt v. Hardware Dealers Mut. Fire Ins. Co.*, 5th Cir. 112 F. (2d) 140, 143; *General American Life Ins. Co. v. Central Nat. Bank*, 6th Cir., 136 F. (2d) 821, 823; *Adams v. United States*, 7th Cir. 116 F. (2d) 199, 202; *Childs v. Radzevich*, D. C. Cir., 139 F. (2d) 374. This confusion and the continuing conflict among the circuits with respect to so important a question as the proper standard to be applied upon a motion for a directed verdict gives added emphasis to the reasons for granting the writ as set forth in the Petition.

While the greater part of respondent's brief is devoted to an analysis of the evidence in terms of its weight, framed as though this were a motion for a new trial, we do not feel required to answer in those terms which we think irrelevant.

2. Respondent's entire attempt to answer petitioner's claim that the assignment of his employment contract carried with it an implied warranty that the contract was not subject to unilateral termination by Klein is to be found in the seventeen lines at pp. 48-49 of his brief. Respondent there seems to assume that we rely on a warranty of *fitness for purpose*. But petitioner is not relying on a fitness warranty, quite apart from any doubts there may be as to whether such a warranty has any application to the assignment of a chose in action.

Petitioner has shown at page 35 of its brief that under the New York law there is an implied warranty when rights under a contract are assigned that such rights are not sub-

ject to termination as a result of the prior misconduct of the assignor. Respondent cites no authority to the contrary. The court below conceded that an assignor ordinarily makes such an implied warranty (R. 196).

Petitioner's argument is that the court below erred in holding that under New York law an implied warranty may be negated by any facts short of an express provision in the contract or acts which would preclude reliance. Moreover, even if the court below was correct in stating that a warranty may be implied only where *the facts* do not show a contrary intention, it erred in sustaining the directed verdict because it was for the jury to determine the fact of intention—the jury was free to find that petitioner would not have paid \$200,000 to enable its prospective subsidiary to terminate respondent's contract if it had known that the subsidiary was itself free to terminate them.

3. At pp. 14-15, 35, 36, 43 and 45 respondent asserts that the securities agreement and letter agreement were consideration for one another because respondent would not have sold his securities unless petitioner purchased his rights under the employment contract. The only citations to the record which respondent gives are ff. 330-331 and 336. But nowhere in those folios—or anywhere else in the record—does any such testimony appear. At the cited folios, Diamond testified that respondent's securities could not be purchased by petitioner unless respondent agreed to sell them, and that all the stockholders had a prior right to purchase each other's securities upon a sale. But Diamond did not testify that respondent would not have sold his securities had petitioner declined to purchase the contract rights. In fact, his testimony is to the contrary (R. 105). It should be noted that respondent took the stand several times during the course of the trial but at no time did he testify that he would not have sold his securities had petitioner refused to purchase the employment contract rights.

It is true, as respondent states, that the letter agreement was, by its terms, conditioned upon a closing under the securities agreement (R. 152). That was done because petitioner sought to relieve a prospective subsidiary of what had been represented to petitioner to be (and of what it believed to be) rights not subject to unilateral termination by the prospective subsidiary. Of course, if Klein were not to become a subsidiary of petitioner, it would have no interest in the employment contract. It will be noted, however, that the *securities agreement* was in no way conditioned on the *letter agreement*.

The only *fact* upon which respondent and the court below contend that the securities agreement and letter agreement were consideration for one another is that they were executed on the same day. Petitioner cited *Petze v. Leary*, 117 App. Div. 829 and *Topken, Loring & Schwartz, Inc. v. Schwartz*, 249 N. Y. 206, 208, 211 in support of its contention that under New York law such an inference may not be made. Respondent notes at page 50 of his brief that the *Petze* case states that the execution of one contract *may* constitute consideration for the execution of a second contract. But this dictum appears in no way inconsistent with the holding that the simultaneous execution of two contracts is insufficient to prove that the execution of one contract was consideration for the execution of the second even though one merely provides for additional consideration for carrying out the second.

In the *Topken* case, defendant entered into an employment contract with plaintiff corporation. In a separate contract, executed the same day, defendant purchased some stock in plaintiff corporation and it was agreed that, upon termination of defendant's employment, defendant would sell and plaintiff would repurchase the stock (249 N. Y. at 208). It was held that the corporation's promise to repurchase the stock did not constitute a valid consideration because it was illusory in view of the limitations upon a corporation's power to purchase its own stock.

The New York Court of Appeals stated, however, that there would have been valid consideration for the securities contract had it been shown that the execution of the employment contract was consideration for the securities contract (249 N. Y. at 211). Since the Court found no consideration had been furnished by the corporation, it held that the execution of both contracts on the same day could not support the implication that one was consideration for the other.

4. Respondent contends (Br. pp. 18-19) that petitioner must show that Klein terminated his employment contract as a result of respondent's misconduct before petitioner may complain of any infirmity in the rights respondent transferred. Petitioner acquired respondent's rights in order to terminate them because it was represented to it, and it believed, that Klein could not unilaterally terminate the contract. Upon the assignment of those rights, respondent left the post of general manager of the store and the employment contract was thus automatically terminated. As to that there is no dispute. When petitioner and Klein learned of respondent's prior misconduct, there was nothing further which could be done because the contract no longer existed.

Respondent goes on to argue that the misconduct alleged was solely against Klein, and that petitioner may therefore not complain. But when petitioner agreed to pay \$200,000 for respondent's rights, it bargained for rights which Klein did not have the *power* unilaterally to terminate. If it failed to receive such rights there was a failure of consideration and breach of both the express and implied warranty irrespective of what Klein did or would have done.

In *Nelson v. Hatch*, 70 App. Div. 206, aff'd. w.o. op. 174 N. Y. 546, the defendant, an attorney, agreed to represent a client on a contingent fee basis. It was agreed that defendant's partner would render services whenever neces-

sary or when requested by the client. Plaintiff agreed with defendant to finance the litigation in return for an assignment of one-half of the partnership's interest in the recovery. Defendant's partner terminated the partnership and withdrew from the litigation. The client agreed that defendant alone should try the case. The plaintiff, not having been consulted, sued to recover the amounts he had advanced. The Court held that there was an implied warranty upon the assignment to plaintiff that defendant's contract with his client would be carried out in accordance with its terms (pp. 211-212), and that the plaintiff, under his warranty, could complain of defendant's departure from the terms of his contract with the client, despite the client's consent thereto.

Respondent's argument that petitioner cannot complain unless Klein actually terminated his employment contract because of his prior misconduct is bottomed on the assumption that petitioner was concerned with what Klein *would* do. Petitioner was acquiring control of Klein; it would decide what Klein would do. Its only concern was with Klein's *power* to act, or at least the jury could have so found.

5. At pp. 39 and 44 of his brief, respondent contends that even if the employment contract were subject to infirmities because Klein could have discharged him, he nevertheless furnished consideration to petitioner by leaving his post without a lawsuit. Under New York law, benefits and detriments do not constitute consideration unless they are bargained for. There is not the slightest evidence in the record that petitioner bargained for freedom from a lawsuit, and hence respondent's leaving his post furnished petitioner with no bargained for consideration if Klein could have discharged him.

In *Tams-Witmark Music Library v. New Opera Co.*, 298 N. Y. 163 (July 16, 1948), defendant agreed to pay royalties for the exercise of certain performing rights which the

plaintiff warranted were within its exclusive possession. Whether or not they were was a doubtful question. It was subsequently decided that those rights were in the public domain. Upon learning of the decision, defendant refused to pay the agreed royalties, alleging failure of consideration and breach of warranty. The New York Court of Appeals sustained its position even though defendant, by virtue of its agreement with plaintiff, had been able to exercise the performing rights free of a lawsuit. The vice of plaintiff's case was that it sought to obtain a payment for the exercise of a right which defendant was free to exercise without payment. Respondent's case is subject to the same deficiency.

6. At pp. 36-37 of respondent's brief the position is taken that the promise contained in the letter agreement to resign as an officer and director of Klein and of its subsidiaries had some special value, greater than the same promise contained in the securities agreement, and that the two promises were simultaneous.

In the securities agreement to which respondent was a party, he promised to deliver at the closing the "Resignations of all Directors, officers, attorneys-in-fact and agents of the [Klein] Corporation and its subsidiaries" (R. 151). The letter agreement provided that in the event of a closing pursuant to the securities agreement, respondent promised "to resign as an officer and director of said company [Klein] and of its subsidiaries" (R. 152). Thus, the promise in the letter agreement added nothing whatever to that contained in the securities agreement and the former would go in effect only after the resignations had already been given. Such a promise cannot constitute consideration under *Petze v. Leary*, 117 App. Div. 829. In that case, plaintiff entered into an employment contract with a corporation, and simultaneously entered into another contract with an officer-stockholder of the corporation under which plaintiff would obtain additional compensation for carrying

out the first contract. The court held that no consideration existed for the second contract.

7. Respondent at pp. 37-39 of his brief distorts petitioner's argument with respect to the negative covenant contained in the letter agreement. He attempts to show that this negative covenant was broader than the one contained in the securities agreement. Petitioner does not argue otherwise. But we do contend (see Br., p. 27) that petitioner obtained all the protection it desired by the negative covenant contained in the securities agreement. Petitioner's testimony was that the negative covenant was inserted solely at respondent's request and to accommodate him (R. 107-108). It was not a significant element of the bargain, and would certainly not have led petitioner to enter into the letter agreement had the infirmities in the employment contract been known.

To buttress his argument as to the value of this negative covenant, respondent's brief states (Br., pp. 38-39) that he had successfully managed Klein for nearly two years. The statement is gratuitous, and nowhere supported in the record, but, since respondent nevertheless feels free to make it, we feel justified in noting that the fact is just to the contrary. During the period of respondent's management, the highly profitable war years, Klein's was, considering the size of its operations, barely in the black. The only record evidence with respect to profits is that respondent's share of 5% thereof before income taxes for 5½ months was \$4,309.96. Respondent concedes the correctness of this figure (Br., p. 49). On an annual basis, this would yield less than \$190,000 profit before taxes—a nominal profit for one of New York City's largest department stores.

Respondent further asserts, without the slightest foundation in the record or in fact, that in a prospectus and registration statement, petitioner "purported to set forth all the advantages resulting to petitioner from the transaction and to put it in the most favorable light". Respond-

ent further asserts again that petitioner listed the negative covenant as an "advantage" but failed to mention any warranty with respect to the letter agreement. The portion of the prospectus and registration statement relied upon purports only to state some of the terms, without suggesting whether they were advantages or disadvantages; the original documents had but a six line summary and they expressly warned (p. 14) that "the foregoing statements are brief summaries" and "Such statements do not purport to be complete".

As Diamond testified (R. 124), there is no Federal requirement that every term and condition be reported unless it is necessary to prevent a statement from being misleading. Section 11(a) of the Securities Act of 1933 requires the revelation of any material fact "necessary to make the statements therein not misleading" and Section 17(a) requires the revelation of any material fact "necessary in order to make the statement made, in the light of the circumstances under which they were made, not misleading . . ." There was no requirement that the express warranty be revealed, but if the appellant had had any knowledge of any infirmities in the letter agreement, or if it had paid respondent to be free of a possible lawsuit, it would have been necessary to reveal those facts.

8. Diamond testified in part that the substance and meaning of what respondent had represented and warranted to him was that the employment contract was "free from infirmities" (R. 105-106, 109, 115). Respondent asserts (Br. pp. 33-34), without citing any authority, that Diamond's testimony "did not establish the making of the alleged representation" because only the meaning of respondent's words and not the exact words had been given. The New York and Federal authorities cited by petitioner in its brief at pp. 19-20 establish that testimony giving the meaning of the words used is sufficient to prove a representation and warranty.

9. In its main brief, petitioner argued that the \$200,000 which it agreed to give respondent was of such size that a jury could have found that it represented the full value of respondent's contract, and hence was not arrived at as a compromise figure paid to avoid a lawsuit. Respondent objects (Br. p. 49) to this statement. At the date of the closing, the employment contract had 3 years, 1½ months to run. During that period respondent would have received \$30,000 per annum as salary, and 5% of the net profits. Respondent concedes that respondent's share of the profits before taxes for 5½ months was \$4,309.96. On that basis, respondent would have received, in salary and in profit-sharing, less than \$125,000 over the remaining period of his contract (computed on an annual average profit before taxes of \$188,000).

Respondent argues that the 5½ months profit figure was not representative because improvements were made in the store during that period. First, we note that under accepted accounting practice improvements are written off over their life so that the year in which they are made does not yield unusual results on that account. Second, there is no testimony that such improvements were made. If we are to go outside the record, we may as well look at the actual operating results under respondent's management. During the full fiscal year following the 5½ month period (October 1, 1944 to September 30, 1945), Klein's own statement of profit and loss showed a profit of only \$149,799.10 before taxes, and of \$73,095.81 after taxes. Hence, despite respondent's complaints, petitioner's assumption, supported by the record, of a profit before taxes of \$188,000 per annum is somewhat generous to respondent.

10. Respondent argues at numerous points that petitioner made its own investigation in entering into the letter agreement with respondent and therefore cannot rely upon respondent's representations (Br. pp. 5-6, 33, 34-35). As petitioner pointed out in its brief at page 31,

the letter agreement contained no provision for an investigation. Such provision was contained only in the securities agreement and only with respect to the representations made in that agreement.

It should first be noted that respondent cannot contend that petitioner did not rely upon his representations in entering into the letter agreement since it had conducted an investigation under the securities agreement because *the investigation was made after the letter agreement was executed*. That is the short answer to respondent's argument of lack of reliance. In addition, we reiterate that the investigation was solely with respect to the securities agreement. When respondent states at page 33 of his brief that petitioner "expressed itself as satisfied, and prepared to close and did close the deal (f. 485)" he is talking solely of the securities agreement. The letter in the record to which reference is made is addressed to the signatories of the securities agreement, and it expressly refers only to the purchase of the securities. Finally, we note that in connection with the securities investigation, petitioner could not discover anything with respect to respondent's misconduct because they were not revealed by the records, as will be shown below.

At pp. 32-33 of its brief petitioner cites the evidence in the record from which the jury could have found that respondent fraudulently procured the write-off by Klein of his personal charges appearing on its books. Respondent argues that the charge on the books merely created an indebtedness; that, however, does not justify his fraud in procuring the write-off. Respondent argues that he might have offset that sum against the monies due him from Klein—"a practice which was apparently followed on other occasions (f. 307)." But respondent never offset such personal charges; he had them written-off without payment upon fraudulent representations. Moreover, the "practice" to which he refers was simply another conversion of corporate property by respondent himself. The

facts concerning the latter act are set forth in petitioner's brief at pp. 30-31.

In purporting to summarize the record in his brief at pp. 22-23, respondent attempts to make much of the failure of Kuchai (petitioner's president) to testify with respect to the write-off of the charges. Respondent fails to state that he, himself, had testified (R. 74) that he had negotiated for petitioner's consent to the write-off with Diamond. Diamond did testify, and stated that respondent did not reveal that the charges were actually personal ones rather than for corporate purposes, as stated in the resolutions passed by the Klein directors and stockholders. Diamond further denied that he (Diamond) had suggested the false resolutions (R. 108). Moreover, respondent fails to point out that Hand ~~her~~, chairman of the Klein board, testified (R. 127) that the directors' and stockholders' resolutions correctly reported that respondent had represented to the meetings that the charges had been incurred for corporate purposes. On this conflict of testimony, respondent urges that his version be accepted by the Court. This is precisely what the court below did; it weighed the credibility of the witnesses.

Respondent attempts to justify his acts by the claim that Klein was a family corporation in which formalities may be disregarded—citing *Gerard v. Empire Square Realty Co.*, 195 App. Div. 244. An examination of that case will reveal that Klein was not a family corporation within the meaning of that term as it is used in the *Gerard* case, and that respondent's acts were not the mere omission of formalities. In the *Gerard* case the sole stockholders (who were also directors) were four brothers and a sister; Klein had at least 38 stockholders (see respondent's brief pp. 23-24), some of whom were in some way related to the late Samuel Klein, some of whom were employees of Klein, and some of whom were simply outside investors. Only a fraction of the stockholders were directors. In the *Gerard* case, all stockholder-directors had approved a con-

tract, but this had been done individually, without a meeting because of personal bickering. In the instant case, respondent is charged with procuring the write-off of personal charges on the corporate books, and he has admitted the conversion of corporate funds.

The holding that in a closely held, family corporation, unanimous approval sufficed without a meeting does not justify respondent's acts. The Court stated in the *Gerard* case, at p. 249:

"I think that under the circumstances of the case we are considering, where the directors own all the capital stock of the corporations, where they are members of the same family but so at variance that directors' and stockholders' meetings are not held, their action, concurred in by all, although, separately and not as a body, binds the corporation. We must recognize the fact that to a greater and greater degree all business, great and small, is being brought under the management of corporations instead of partnerships; that they are, in perhaps the majority of instances, conducted by officers and directors little informed in the law of corporations, who often act informally, sometimes without meetings or even by-laws. To hold that in all instances technical conformity to the requirements of the law of corporations is a condition to a valid action by the directors, would be to lay down a rule of law which could be used as a trap for the unwary who deal with corporations, and to permit corporations sometimes to escape liability to which an individual in the same circumstances would be subjected."

Respondent also contends that his conversion of \$63,000 of corporate funds constituted a mere "technical irregularity" (Br. pp. 29-33). He attempts to throw a charitable purpose around his first conversion of \$50,000 by asserting that it was for the benefit of the family, relatives and employees of S. Klein. He omits to point out that the money was used to repay a loan he had made in order to purchase \$100,000 of securities for himself (R. 99).

Respondent's assertion that Klein knew about the conversion is predicated upon the "Even Exchange" entry in the books. But Jayson, who was the Klein auditor at the time of the transaction, admitted in his testimony that the entry did not reveal a personal use of corporate funds (R. 138). This is obviously so since an "even exchange" involves no net withdrawal; it is a simultaneous exchange. Moreover, the entries did not appear on the monthly statements given to the directors (R. 130), and Handmacher, chairman of the Board (and the only person specifically named by respondent during his testimony as having been informed by him of the withdrawal) denied having any knowledge thereof (R. 128-129). Respondent's only answer is to attack Handmacher's credibility (Br. pp. 30-31)—an issue clearly for the jury. Respondent at numerous points attempts to imply that evidence appears in the record by stating questions propounded to a witness although a negative answer was received, and no testimony to the contrary appears. For example, at page 30 respondent states in his brief that Handmacher denied knowing that Berkeley and Rosenblum, members of the Klein executive committee, had each loaned respondent \$25,000 to repay \$50,000 to Klein. The statement implies that there is other testimony in the record that these two directors had loaned respondent the stated sums to repay the corporation. Actually, there is no such testimony that they had loaned him anything.

Respondent attempts to justify his conversion of \$13,000 (Br. p. 32) on the ground that he mistakenly believed that his share of the profits to become due from Klein was a greater sum. The explanation is specious, for (as petitioner pointed out at pp. 30-31 of its brief), respondent was not entitled under his contract to any payment until the close of the fiscal year, and the conversion occurred before that date.

It should be emphasized that respondent makes no attempt to distinguish or controvert the applicability of the

statutes and cases set forth at pages 32 and 36 of petitioner's brief, which hold it to be unlawful for a corporation such as Klein to lend its funds to a stockholder, the respondent, and which hold that the use by an officer of corporate funds for his personal benefit constitutes a conversion even if the directors of the corporation consent. In the face of this law, respondent still asserts that his conversion constituted only a "technical irregularity," not justifying his discharge, although no authority is cited in support of that view.

Respectfully submitted,

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